

Version

2.0

INVESTMENT POLICY

For Reserves and Temporarily Idle Funds

City of Franklin

CITY OF FRANKLIN

Investment Policy

Prepared by

Finance Department Staff

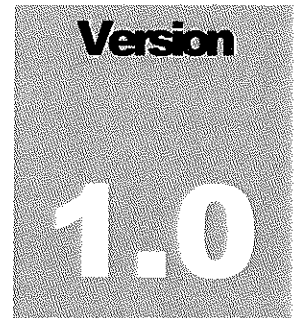
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Adopted by Finance Committee, July 6, 2004

Adopted by Board of Mayor & Aldermen, July 13, 2004



I. GFOA Sample Investment Policy As Source Document

This investment policy is derived from the model investment policy created by the Government Finance Officers Association (GFOA) to aid its general membership in the preparation of an investment policy. The sample policy was intended to help cities that invest to customize a policy to fit their particular needs, constraints and capabilities.

The Finance Department staff has amended and supplemented the sample policy to adjust for the goals and objectives of the City of Franklin and those circumstances that are unique to the City. These circumstances include: budget size, composition of departments, cash flow needs to support city services, current fund balance, current and estimated future demands for reserves, and market equilibrium.

The use of this sample policy as a foundation is intended to give a standardized presentation to the City policy, and to make certain that those issues identified at the national level as significant are included.

Management of the procedural details of investment of public funds is delegated to the Finance Department.

II. Governing Authority

The investment program shall be operated in conformance with federal, state, and other legal requirements, including TCA 6-56-106, titled Authorized Investments, which governs the investment of public funds by cities and towns. (Appendix A)

III. Scope

This policy applies to the investment of all funds, excluding the investment of the City of Franklin retirement funds. Retirement funds and proceeds from certain bond issues, as well as separate foundation or endowment assets, are covered by a separate policies.

1. Pooling of Funds

Except for cash in certain restricted and special funds, the City will consolidate cash and reserve balances from all funds to maximize investment earnings and to increase efficiencies with regard to investment pricing, safekeeping and administration. Investment income will be allocated to the various funds based on their respective participation and in accordance with generally accepted accounting principles.

2. Special Funds

Those funds that are considered restricted and special funds are: City of Franklin Employee Retirement Fund, Adequate Facilities Tax Fund, Road Impact Fund, Stormwater Fund, and retainage accounts.

IV. General Objectives

The primary objectives, in order of priority, of investment activities shall be safety, liquidity, and return.

1. *Safety*

Safety of principal is the foremost objective of the investment program. Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. The objective will be to mitigate

credit risk and interest rate risk.

a. *Credit Risk*

The City will minimize credit risk, which is the risk of loss due to the failure of the security issuer or backer, by:

Limiting investments to the types of securities listed in Section VIII of this Investment Policy;

Pre-qualifying the financial institutions, broker/dealers, intermediaries, and advisers with which the City will do business in accordance with Section VI;

Diversifying the investment portfolio so that the impact of potential losses from any one type of security or from any one individual issuer will be minimized.

b. *Interest Rate Risk*

The City will minimize interest rate risk, which is the risk that the market value of securities in the portfolio will fall due to changes in market interest rates, by:

Structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities on the open market prior to maturity;

Investing operating funds primarily in shorter-term securities, money market mutual funds, or similar investment pools and limiting the average maturity of the portfolio in accordance with this policy.

2. *Liquidity*

The investment portfolio shall remain sufficiently liquid to meet all operating requirements that may be reasonably anticipated. This is accomplished by structuring the

portfolio so that securities mature concurrent with cash needs to meet anticipated demands (static liquidity). Furthermore, since all possible cash demands cannot be anticipated, the portfolio should consist largely of securities with active secondary or resale markets (dynamic liquidity). Alternatively, a portion of the portfolio may be placed in money market mutual funds, bank repurchase agreements, or local government investment pools, which offer same-day liquidity for short-term funds.

3. *Return*

The investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the investment risk constraints and liquidity needs. Return on

investment is of secondary importance compared to the safety and liquidity objectives described above. The core of investments is limited to relatively low risk securities in anticipation of earning a fair return relative to the risk being assumed. Securities shall generally be held until maturity with the following exceptions:

A security with declining credit may be sold early to minimize loss of principal;

A security swap would improve the quality, yield, or target duration in the portfolio;

Liquidity needs of the portfolio require that the security be sold.

The City's cash management portfolio shall be designed with the objective of regularly meeting or exceeding a performance benchmark, such as the average return on three-month U.S. Treasury bills, the state investment pool, or the average rate on Fed funds, whichever is higher. These indices are considered benchmarks for lower risk investment transactions and therefore comprise a minimum standard for the portfolio's rate of return. The investment program shall seek to augment returns above this threshold, consistent with risk limitations identified herein and prudent investment principles.

4. *Local Considerations*

The City of Franklin seeks to promote local economic development through various programs and activities. Included is a program of rewarding local financial institutions that increase their commitments to private

economic growth and local housing investment.

The City may accept a proposal from an eligible institution that provides for a reduced rate of interest provided that such institution documents the use of deposited funds for community development projects.

The Board of Mayor and Aldermen recognizes that a Linked Deposit Program might diminish short-term investment yields by up to 10 basis points in exchange for potential expansion of the tax base.

V. Standards of Care

1. *Prudence*

The standard of prudence to be used by investment officials shall be the "prudent person" standard and shall be applied in the context of managing an overall portfolio.

Investment officers acting in accordance with written procedures and this investment policy and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided deviations from expectations are reported in a timely fashion and appropriate action is taken to control adverse developments.

The "prudent person" standard states that "investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived."

2. *Ethics and Conflicts of Interest*

Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with the proper execution and management of the investment program, or that could impair their ability to

make impartial decisions. Employees and investment officials shall disclose any material interests in financial institutions with which they conduct business. They shall further disclose any personal financial/investment positions that could be related to the performance of the investment portfolio. Employees and officers shall refrain from undertaking personal investment transactions with the same individual with whom business is conducted on behalf of the City.

3. *Delegation of Authority*

The Board of Mayor & Aldermen will retain ultimate fiduciary responsibility for the portfolios. The Board or its designated committee shall receive monthly reports, designate investment officers and review the investment

policy making any changes necessary by adoption. Authority to manage the investment program is granted to Chief Financial Officer, hereinafter referred to as investment officer. Responsibility for the operation of the investment program is hereby delegated to the investment officer, who shall act in accordance with

established written procedures and internal controls for the operation of the investment program consistent with this investment policy. The investment officer will prepare, or cause to be prepared, monthly investment reports and other special reports as may be deemed necessary. All participants in the investment process shall seek to act responsibly as custodians of the public trust. No officer or designee may engage in an investment transaction except as provided under the terms of this policy and the supporting. . The City may seek to establish an investment committee, or assign the Budget & Finance Committee or its successor as the investment committee, to provide guidance to investment officers. The City of Franklin may engage the services of one or more external investment managers to assist in the management of the investment portfolio in a manner consistent with the City's objectives. Such external managers may be granted discretion to purchase and sell investment securities in accordance with the Investment Policy. Such managers must be registered under the Investment Adviser Act of 1940.

VI. Authorized Financial Institutions, Depositories, and Broker/Dealers

1. Authorized Financial Institutions, Depositories, and Broker/Dealers

A list will be maintained of financial institutions and depositories authorized to provide investment services. In addition, a list will be maintained of approved security broker/dealers selected by conducting a process of due diligence. These may include "primary" dealers or regional dealers that qualify under Securities and Exchange Commission (SEC) Rule 15C3-1 (uniform net capital rule).

A. The investment officer shall determine which financial institutions are authorized to provide investment services to the City. Institutions eligible to transact investment business include:

- 1) Primary government dealers as designated by the Federal Reserve Bank;
- 2) Nationally or state-chartered banks;
- 3) The Federal Reserve Bank; and,
- 4) Direct issuers of securities eligible for purchase.

- B. Selection of financial institutions and broker/dealers authorized to engage in transactions with the City shall be at the sole discretion of the City.
- C. All broker/dealers who desire to become qualified for investment transactions must supply the following, as appropriate:
 - 1) Audited financial statements demonstrating compliance with state and federal capital adequacy guidelines;
 - 2) Proof of National Association of Securities Dealers (NASD) certification (not applicable to Certificate of Deposit counterparties);
 - 3) Proof of state registration;
 - 4) Completed broker/dealer questionnaire (not applicable to Certificate of Deposit counterparties);
 - 5) Certification of having read and understood and agreeing to comply with the City's investment policy;
 - 6) Evidence of adequate insurance coverage.
- D. All financial institutions who desire to become depositories must supply the following, as appropriate:
 - 1. Audited financial statements demonstrating compliance with state and federal capital adequacy guidelines
 - 2. Proof of state registration
 - 3. Evidence of adequate insurance coverage.
- E. An annual review of the financial condition and registration of all qualified financial institutions and broker/dealers will be conducted by the investment officer.

2. Minority and Community Financial Institutions

From time to time, the investment officer may choose to invest in instruments offered by minority and community financial institutions. All terms and relationships will be fully disclosed prior to purchase, will be reported to the Budget and Finance Committee on a regular basis, and should be consistent with state or local law.

VII. Safekeeping and Custody

1. *Delivery vs. Payment*

All trades of marketable securities will be executed (cleared and settled) on a delivery vs. payment (DVP) basis to ensure that securities are deposited in the City's safekeeping institution prior to the release of funds.

2. *Safekeeping*

Securities will be held by a centralized independent third-party safekeeping institution selected by the City. All securities will be evidenced by safekeeping receipts in the City's name. The safekeeping institution shall annually provide a copy of their most recent report on internal controls (Service Organization Control Reports, formerly Statement of Auditing Standards No. 70, or SAS 70) prepared in accordance with the Statement on Standards for Attestation Engagement (SSAE) No.16 (effective June 15,2011).

3. *Internal Controls*

Management is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the City are protected from loss, theft or misuse. Specifics for the internal controls system shall be documented in an investment procedures manual and shall be reviewed and updated periodically by the investment officers. The internal control structure shall be designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that (1) the cost of a control should not exceed the benefits likely to be derived and (2) the valuation of costs and benefits requires estimates and judgments by management.

The internal controls structure shall address the following points:

- Control of collusion
- Separation of transaction authority from accounting and record keeping
- Custodial safekeeping
- Avoidance of physical delivery securities

- Clear delegation of authority to subordinate staff members
- Written confirmation of transactions for investments and wire transfers
- Dual authorizations of wire transfers
- Staff training, and

Review, maintenance and monitoring of security procedures both manual and automated. Management shall make certain that the internal controls are reviewed by the Budget & Finance committee and with the independent auditor. The controls shall be designed to prevent the loss of public funds arising from fraud, employee error, misrepresentation by third parties, unanticipated changes in financial markets, or imprudent actions by employees and officers of the City.

VIII. Suitable and Authorized Investments

1. Investment Types & Credit Guidelines

Consistent with the GFOA Policy Statement on State and Local Laws Concerning Investment Practices, the following investments will be permitted by this policy and are those defined by state and local law where applicable.

If additional types of securities are approved for investment by public funds by State statute, they will not be eligible for investment by the City until this Policy has been amended and the amended version adopted by the Board of Mayor & Aldermen. Types of securities include:

- U.S. Treasury and other government obligations that carry the full faith and credit guarantee of the United States for the payment of principal and interest;
- Federal agency or U. S. government sponsored enterprises (GSE) obligations, participations or other instruments ;
- Negotiable certificates of deposit,
- Federally insured time deposits (non-negotiable certificates of deposit) in state of federally chartered banks, savings and loan or credit unions, provided that the amount per institution is limited to the maximum covered under federal insurance;

- Time deposits (non-negotiable certificates of deposit) in state or federally chartered banks, savings and loans, or credit unions in excess of insured amounts which are fully collateralized with securities in accordance with State law;
- Bankers' acceptances;
- Commercial paper, rated in the highest tier (e.g., A-1, P-1, F-1, or D-1 or higher) by a nationally recognized rating agency;
- Investment-grade obligations of state, provincial and local governments and public authorities;
- Fully collateralized repurchase agreements collateralized in compliance with this Policy, governed by a SIFMA Master Repurchase Agreement and with a maximum maturity. Capital project funds may be invested in a single flex repurchase agreement with a maximum stated maturity that shall be matched to the expenditure plan ;
- SEC-registered ,money market mutual ; and
- Local government investment pools.

If the credit rating of a security is subsequently downgraded below the minimum rating level for a new investment of that security, the Investment Officer shall evaluate the downgrade on a case-by-case basis in order to determine if the security should be held or sold. The Investment Officer will apply the general objectives of safety, liquidity, yield and legality to make the decision.

2. Collateralization

In accordance with State law (TCA 9-4-105) and the GFOA Recommended Practices on the Collateralization of Public Deposits, full collateralization will be required on all demand deposit accounts, including checking accounts, negotiable certificates of deposit, and non-negotiable certificates of deposit, except in the following instances: 1) when the institution issuing the certificate of deposit belongs to the State of Tennessee Collateral Pool, or 2) in the case where CDRS (Certificate of Deposit Account Registry Services) are used in lieu of collateralization.

IX. Investment Parameters

1. Diversification

It is the policy of the City to diversify its investment portfolios. To eliminate risk of loss resulting from the over-concentration of assets in a specific maturity, issuer, or class of securities, assets in all City funds shall be diversified by maturity, issuer, and class of security. Diversification strategies shall be determined and revised periodically by the investment committee/investment officer for all funds except for the employee retirement fund.

The investments shall be diversified by:

- limiting investments to avoid over concentration in securities from a specific issuer or business sector (excluding U.S. Treasury securities),
- limiting investment in securities that have higher credit risks,
- investing in securities with varying maturities, and
- continuously investing a portion of the portfolio in readily available funds such as local government investment pools (LGIPs), money market funds or overnight repurchase agreements to ensure that appropriate liquidity is maintained in order to meet ongoing obligations.

In establishing specific diversification strategies, the following general policies and constraints shall apply:

- Portfolio maturities shall be staggered to avoid undue concentration of assets in a specific maturity sector. Maturities selected shall provide for stability of income and reasonable liquidity.
- For cash management funds, liquidity shall be assured through practices ensuring that the next disbursement date and payroll date are covered through maturing investments or marketable U.S. Treasury bills.
- Positions in securities having potential default risk (e.g., commercial paper) shall be limited in size so that in case of default, the portfolio's annual investment income will exceed a loss on a single issuer's securities.

- Risks of market price volatility shall be controlled through maturity diversification such that aggregate price losses on instruments with maturities exceeding one year shall not be greater than coupon interest and investment income received from the balance of the portfolio.

The investment committee/investment officer shall establish strategies and guidelines for the percentage of the total portfolio that may be invested in securities other than repurchase agreements, Treasury bills or collateralized certificates of deposit. The committee shall conduct periodic review of these guidelines and evaluate the probability of market and default risk in various investment sectors as part of its considerations.

2. Mitigating Market Risk in the Portfolio

Market risk is the risk that the portfolio value will fluctuate due to changes in the general level of interest rates. The City recognizes that, over time, longer-term/core portfolios have the potential to achieve higher returns. On the other hand, longer-term portfolios have higher volatility of return. The City shall mitigate market risk by providing adequate liquidity for short-term cash needs, and by making longer-term investments only with funds that are not needed for current cash flow purposes. The City further recognizes that certain types of securities, including variable rate securities, securities with principal paydowns prior to maturity, and securities with embedded options, will affect the market risk profile of the portfolio differently in different interest rate environments. The City, therefore, adopts the following strategies to control and mitigate its exposure to market risk:

- The City shall maintain a minimum of three months of budgeted operating expenditures in short term investments to provide sufficient liquidity for expected disbursements;
- The maximum percent of callable securities in the portfolio shall be 15%;
- The maximum stated final maturity of individual securities in the portfolio shall be five years except as otherwise stated in this policy; and
- Liquidity funds will be held in the State Investment Pool or in money market instruments maturing one year and shorter;
- Longer term/core funds will be defined as the funds in excess of liquidity requirements. The investments in this portion of the portfolio will have maturities between one day and five years and will be only invested in higher quality and liquid securities;

- The duration of the portfolio shall at all times be approximately equal to the duration (plus or minus ten percent) of a market benchmark index selected by the City based on the City's investment objectives, constraints and risk tolerances. The City's current Benchmark shall be documented in the Investment Procedures Manual.

Total Portfolio Maturity Constraints;

- Under 30 days:
- Under one year:
- Under 5 years
- Weighted Average Maturity (WAM):

Exceptions to the five year maturity maximum: Reserve or Capital Improvement Project monies may be invested in securities exceeding five years if the maturities of such investments are made to coincide as nearly as practicable with the expected use of the funds.

Due to fluctuations in the aggregate surplus funds balance, maximum percentages for a particular issuer or investment type may be exceeded at a point in time subsequent to the purchase of a particular issuer or investment type or security. Securities need not be liquidated to realign the portfolio; however, consideration should be given to this matter when future purchases are made.

3. *Competitive Bids*

The investment officer shall obtain competitive bids from at least two brokers or financial institutions on all purchases of investment instruments purchased on the secondary market.

X. Performance Standards

1. *Evaluation*

The City's cash management portfolio shall be designed with the objective of regularly meeting or exceeding a selected performance benchmark, which could be the

average return on three-month U.S. Treasury bills, the state investment pool, a money market mutual fund or the average rate of Fed funds. These indices are considered benchmarks for lower risk investment transactions and therefore comprise a minimum standard for the portfolio's rate of return.

XI. Reporting

1. Methods

The investment officer shall prepare an investment report at least quarterly, including a management summary that provides an analysis of the status of the current investment portfolio and the individual transactions executed over the last quarter. This management summary will be prepared in a manner which will allow the City to ascertain whether investment activities during the reporting period have conformed to the investment policy. The report should be provided to the City Administrator, the Board of Mayor and Aldermen, and the Finance Committee. The report will include the following:

- a. An asset listing of individual securities showing par value, cost and accurate and complete market value of each security, type of investment, issuer, and interest rate
- b. Average maturity of the portfolio and modified duration of the portfolio
- c. Maturity distribution of the portfolio
- d. Average portfolio credit quality
- e. Time-weighted total rate of return for the portfolio for the prior one month, three months, twelve months, year-to-date, and since inception compared to the Benchmark Index returns for the same periods
- f. Average weighted yield to maturity of the portfolio on investments as compared to applicable benchmarks
- g. Distribution by type of investment

Each quarterly report shall indicate any areas of policy concern and suggested or planned revision of investment strategies. The report shall explain the quarter's total investment return and compare the return with budgetary expectations. The report shall be in compliance with state law and shall be distributed to the investment

committee and others as required by law. Copies shall be transmitted to the independent auditor.

Within 40 days of the end of the fiscal year, the investment officer shall present a comprehensive annual report on the investment program and investment activity. The annual report shall include 12-month and separate quarterly comparisons of return and shall suggest policies and improvements that might be made in the investment program. Alternatively, this report may be included within the City annual Comprehensive Annual Financial Report.

XII. Marking to Market

Market Valuation

The market value of the portfolio shall be calculated at least quarterly and a statement of the market value of the portfolio shall be issued at least quarterly. This will ensure that review of the investment portfolio, in terms of value and price volatility, has been performed consistent with the GFOA Best Practice on “mark to market” practices for State and Local Government Investment Portfolios.

XIII. Policy Considerations

1. Exemption

Any investment currently held that does not meet the guidelines of this policy shall be exempted from the requirements of this policy. At maturity or liquidation, such monies shall be reinvested only as provided by this policy.

2. Amendments

This policy shall be reviewed on an annual basis. Any changes must be approved by the investment officer and the Finance Committee, as well as being reviewed by the individuals charged with maintaining internal controls.

XIV. Approval of Investment Policy

Approval of Investment Policy

The investment policy shall be formally approved and adopted by the governing body of the City.

XV. List of Attachments and Other Documentation

The following documents are attached to this policy:

- Appendix A: Investments authorized by State statute;
- Appendix B: Collateralization required by State statute;
- Appendix C: City ordinance on deposits and investments
- Appendix D: Listing of authorized personnel
- Appendix E: Listing of authorized broker/dealers and financial institutions
- Appendix F: Investment Procedures Manual
- Appendix G: Safekeeping Agreements
- Appendix H: Master Repurchase Agreements

Appendix I:	Broker/Dealer Questionnaire
Appendix J:	Broker/Dealer Certification
Appendix K:	Wire transfer Agreements
Appendix L:	Sample investment report
Appendix M:	GFOA Best Practices
Appendix N:	Methodology for calculating rate of return
Appendix O:	Glossary

